

BEFORE  
THE PUBLIC SERVICE COMMISSION OF  
SOUTH CAROLINA  
DOCKET NO. 98-378-C – ORDER NO. 98-1029  
DECEMBER 29, 1998

IN RE: Petition of BellSouth Telecommunications, Inc.	)	ORDER
(BST) for the Establishment of a Wholesale	)	ESTABLISHING
Discount for Contract Service Arrangements.	)	DISCOUNT

/s/ MR

**STATEMENT OF THE CASE**

This matter is before the Public Service Commission of South Carolina (“Commission”) upon a Petition filed on July 27, 1998, by BellSouth Telecommunications, Inc. (“BST”) in which BST sought to open a proceeding to establish a wholesale discount rate for BST’s contract service arrangements<sup>1</sup> (“CSAs”) and to establish reasonable and nondiscriminatory limitations of the resale of BST’s CSAs by competing local exchange carriers (“CLECs”). In its Petition, BST acknowledged that the Commission had “previously determined that BST must make available for resale but does not need to discount the price for the CSAs -- since the rates contained in the CSAs have already been discounted from the tariffed rates.” BST’s Petition, p.2, ¶ 5. In making its earlier decision, the Commission “ruled that its position on the resale of CSAs is a reasonable and nondiscriminatory limitation on resale under

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<sup>1</sup> According to BST’s Petition, “a CSA is a contract that BST has negotiated with a specific customer in response to a competitive situation. CSAs typically contain terms, conditions, and rates that are more favorable than those found in BST’s tariffs. CSAs give BST the pricing flexibility necessary to compete with other providers of these services. All CSAs must be approved by the Commission.” BST Petition, p.2, ¶ 4.

the 1996 Act. 47 U.S.A. § 251(c)(4)(B).” BST Petition, pp.2-3, ¶ 5. While BST expressed agreement with “the Commission’s treatment of CSAs [as] a reasonable, nondiscriminatory, and narrowly tailored limitation on resale,” BST also acknowledged that “it is equally clear that the Federal Communications Commission will not approve BST’s application for interLATA relief in South Carolina under the 1996 Act unless BST agrees to the resale of CSAs at a discount.” BST Petition, p.3, ¶ 6. “As a consequence [of the position of the Federal Communications Commission], BST has determined it is willing to go voluntarily beyond what the law requires and to allow the resale at a discount of CSAs in South Carolina.” BST Petition, p.3, ¶ 6.

By letter dated August 19, 1998, the Commission’s Acting Executive Director instructed BST to publish, one time, a prepared Notice of Filing and Hearing in newspapers of general circulation in the areas affected by the Petition and to provide proof of publication of the publishing of the Notice of Filing and Hearing. The purpose of the Notice of Filing and Hearing was to inform interested parties of the manner and time in which to file the appropriate pleadings for inclusion in the proceedings as well as to provide notice of the hearing scheduled in this matter. BST complied with the instructions of the Acting Executive Director and provided the Commission with proof of publication. Petitions to Intervene were received from the Consumer Advocate for the State of South Carolina (“Consumer Advocate”), South Carolina Cable Television Association (“SCCTA”), Knology of South Carolina, Inc. (“Knology”), American Communications Services, Inc. d/b/a e.spire (“e.spire”), and the Southeastern Competitive Carriers Association (“SECCA”).

A hearing on this matter was convened on October 22, 1998, at 10:30 A.M. in the Commission's hearing room. The Honorable Philip T. Bradley, Chairman, presided. BST was represented by Caroline N. Watson, Esquire and William F. Austin, Esquire. Representing the Intervenors were Elliot F. Elam, Jr., Esquire for the Consumer Advocate; Frank R. Ellerbe, III, Esquire for the SCCTA; Russell B. Shetterly, Esquire for both Knology and e.spire; Frank R. Ellerbe, III, Esquire and Martha P. McMillan, Esquire for the SCCA. Florence P. Belser, Staff Counsel represented the Commission Staff. BST presented witnesses Alphonso J. Varner and Walter S. Reid.

### **FINDINGS OF FACT**

Based upon the evidence presented at the hearing, the Commission makes the following findings of fact:

1. An avoided cost discount for the Special Service Arrangements known as CSAs and Special Assemblies is appropriate and should be established.

Alphonso J. Varner, Senior Director for Regulatory for BST, presented testimony to explain why it is necessary to have a CSA-specific avoided cost discount and to provide the Commission with information to assist in the establishment of reasonable and non-discriminatory limitations on the resale of BST's CSAs by competing local exchange carriers ("CLECS"). Mr. Varner described two types of Special Service Arrangements for which BST seeks to have specific avoided costs discounts established. The first type of Special Service Arrangement described by Mr. Varner is a CSA. According to witness Varner, a CSA is a type of Special Service Arrangement involving customer specific pricing of an existing tariffed service, provided at a discount. A CSA must be filed with and approved by the Commission. Mr. Varner stated that CSAs are offered in response

to competitive situations and typically have large contributions which help keep local rates low. The second type of Special Service Arrangement is a Special Assembly. A Special Assembly involves the development of a new service that is not currently available through an existing tariff offering. Mr. Varner explained that Special Service Arrangements are not used as a response to competitive situations and thus the services provided under a Special Assembly contract are provided at rates that are not discounted.

Mr. Varner stated CSAs provide BST with the ability to respond to competitive situations through the discounting of tariffed rates. BST's General Subscriber Services Tariff ("GSST") contains products and services that are generally available to all end users at the same rates, terms, and conditions. However, BST's tariff also contains provisions which allow BST to provide customer specific arrangements in lieu of existing tariff offerings provided there is reasonable potential for uneconomic bypass of BST's services. Mr. Varner stated that CSAs are typically offered to high volume users seeking services which are subject to competition. While general tariff offerings are available for purchase at the will of the end user, CSAs only exist after a customer enters into a contractual agreement with BST, and CSAs are created for a customer's specific situation and are not generally applicable to other end users.

Mr. Varner reminded the Commission that in Docket No. 96-358-C, the Commission established a general wholesale discount of 14.8% but determined that CSAs, while available for resale, should not receive a further discount below the CSA contract rate. The Commission's decision recognized that CSAs are already discounted and did not provide for a further discount. When BST filed an application with the FCC for authority to provide in-region interLATA service, the FCC denied BST's application

and cited BST's failure to offer CSAs for resale at a wholesale discount as one reason for the denial. Mr. Varner stated that BST believes this Commission's previous ruling regarding the treatment of CSAs to comply with the Act but also stated that BST has made a business decision to seek a CSA-specific discount from the Commission rather than pursue a prolonged court battle with the FCC. Thus BST is proposing that the Commission approve a CSA-specific resale discount.

2. A CSA-specific discount is appropriate, and the BST study for the establishment of a CSA-specific discount with the point of sale as the reference point for determining avoided costs and non-avoided costs should be utilized in the establishment of the CSA-specific discount.

Walter S. Reid, Senior Director for the Finance Department of BST, presented testimony concerning the methodology and results of BST's study that calculates the resale discount for CSAs in South Carolina. Mr. Reid noted that the Commission established a general wholesale discount rate of 14.8% in Docket No. 96-358-C. However, Mr. Reid also testified that CSAs require an avoided cost discount separate from the avoided cost discount of 14.8% already approved because the costs avoided as a result of the resale of individualized custom-tailored CSAs are substantially less than the costs avoided as the result of resale of general tariffed services. Further, Mr. Reid stated that the price under which the CSAs are offered already include a discount off the tariff service rates.

In explaining the methodology utilized by BST for identifying CSA-specific avoided costs, Mr. Reid stated that the methodology is similar to the original resale study but has some differences due to the fact that CSAs have attributes that are distinctly

different from general tariffed services. Mr. Reid testified that BST analyzed functional activity costs underlying amounts charged to specific accounts as listed in the Uniform System of Accounts. Since a CSA is a contract created for a specific customer, all the functional activities performed up to the point of sale are necessary to create the CSA. Therefore, the point of sale was used as the reference point for determining avoided versus non-avoided costs. According to Mr. Reid, if an activity is performed prior to the sale, then its costs is considered not avoided, but if an activity is performed after the sale of the CSA and would not be performed by BST if the CSA is resold, then the costs associated with the activity is considered avoided. Thus for CSAs, post-sale costs are the only costs which logically could be avoided. Mr. Reid further explained that in order for a reseller to have the ability to resell a CSA, BST first had to negotiate and sell retail services to the end user customer.

Mr. Reid testified that for data analysis in the CSA study, BST utilized the same cost data which was used in determining the overall resale discount in South Carolina in Docket No. 96-358-C. Costs that were treated as avoided in determining the overall resale discount study were further analyzed in this CSA study to determine if the costs were either pre-sale or post-sale. Mr. Reid stated that in the case of sales expense, additional information had to be secured to make the determination as to whether the costs were pre-sale or post-sale. Additionally where there was not clear identification of a function as pre-sale or post-sale, these costs were allocated to pre-sale and post-sale on a basis unique for the activity. Support and supervision costs were allocated on the basis of the pre-sale and post-sale ratio, and all advertising costs were treated as pre-sale and thus not avoided since the advertising activity occurs prior to a sale.

Mr. Reid testified that the starting point for BST's CSA resale study was the calculation of the 14.8% resale discount adopted in Docket No. 96-358-C. The next step in the calculation was to analyze the expenses for tariff services in general to determine if the expenses should also be treated as avoided for CSAs. According to Mr. Reid, the unique nature of CSAs results in certain costs that are avoided as the result of resale of tariffed services are not avoided as the result of resale of CSA. Since CSAs are a set of discounted tariffed products and services created as a result of a competitive response, the functions required to create a CSA have to be performed before the CSA can be resold by a CLEC. Costs identified as "pre-sale" are treated as non-avoided in the CSA study because they must be incurred in order for the CSA to exist.

According to Mr. Reid, identified costs that will be avoided are included in expense accounts for Product Management (Account 6611), Sales (Account 6612), and Customer Services (Account 6623). In Product Management Expense (Account 6611), BST identified approximately \$191,000 of the expenses as avoided costs through the analysis of job function codes. A majority of the costs in this account which are not avoided because the activities are necessary in order for the CSA to be created include expenses for such pre-sale activities as Product Service Management, Market Management, Market Research and Supervision and Support activities. Examples of avoided costs in this expense account include customer retention, customer education, support and indirect supervision. In the Sales Expense (Account 6612), BST performed a study which classified activities as pre-sale and post-sale. The study considered only complex business activities since CSAs are only created for large businesses. BST's analysis resulted in 34.75% of the cost being classified as "post-sale" related, which

resulted in \$5,438,000 of avoided costs for this account. With regard to the Customer Services Expenses (Account 6623), the Commission treated 65% of the costs in this account as avoided costs in Docket No. 96-358-C. For purposes of the CSA study, BST used that treatment of avoided costs for this account, resulting in approximately \$37,008,000 in avoided costs.

In Product Advertising Expense (Account 6613), BST treated 100% of the expenses in this account as non-avoided due to the fact that product advertising is performed prior to the CSA's creation. Advertising is part of the effort involved to obtain the customer and is therefore a pre-sale function. As a result of advertising being a pre-sale function, none of the expenses are avoided as a result of the resale of the CSA. Additionally, BST did not treat any overhead costs as avoided costs in the CSA study because the cost calculations used to price CSAs do not include any amounts for overhead. Also, BST treated 100% of the costs for call completion and number services (Operator Services, Accounts 6621 and 6622) as not avoidable. Mr. Reid explained that although a CSA customer may switch to an alternative operator service provider for operator services, such a switch would not result in an avoided costs but would result in the loss of the entire line of operator service business for that customer. This situation does not represent a resale situation. Finally, in the BST CSA cost study, there are no uncollectible costs treated as avoided costs because the cost calculation used to price CSAs does not include uncollectibles. Additionally, Mr. Reid testified that BST does not expect to see any significant difference between uncollectible costs associated with large business customers who have CSAs versus CLECs who resell CSAs.



BST also treated revenues somewhat differently in the CSA resale study. Witness Reid explained that revenues, used as the denominator in the calculation, have been discounted by the effective discount in CSAs excluding the actual CSA revenue.<sup>2</sup> BST deducted CSA revenues from total revenues, discounted the difference by the percentage discount inherent in CSAs, then added back the amount of CSA revenues. The result was a revenue base which was applied to CSA-avoided costs.

The Commission finds that the CSA cost study used by BST is reasonable and appropriate. Because the costs avoided as a result of resale of individualized custom-tailored CSAs are substantially less than the costs avoided as the result of resale of general tariffed services, the Commission finds that a CSA-specific discount is appropriate rather than the general wholesale discount of 14.8% previously established by this Commission in Docket No. 96-358-C. The Commission also finds that for the purposes of determining a CSA-specific wholesale discount rate that it was appropriate to use the same cost data which was used in determining the overall resale discount in South Carolina in Docket No. 96-358-C. Since a CSA is created for a specific customer and since all the functional activities performed up to the point of sale are necessary to create the CSA, the Commission finds that the point of sale is a reasonable and appropriate reference point for determining avoided and non-avoided costs. Thus the Commission finds the BST CSA cost study appropriate and hereby adopts that study.

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<sup>2</sup> Mr. Reid explained that the 15% discount used in the calculation was obtained from a study of CSAs conducted in Louisiana. According to Mr. Reid, the 15% discount obtained from the Louisiana study and used in the calculation was a larger discount than the effective discount for CSAs in South Carolina. Mr. Reid indicated that the use of the 15%, rather than the actual discount obtained from only South Carolina CSAs, resulted in a higher discount to the customer.

3. A wholesale discount rate of 8.98% is appropriate for CSAs, and a wholesale discount rate of 14.8% is appropriate for Special Assemblies.

Based upon the CSA study as explained by Mr. Reid, a discount of 8.98% is appropriate for the resale of CSAs. This 8.98% discount is based upon the calculation of avoided costs using the reference point of the point of sale to determine avoided costs.

On cross-examination, the Consumer Advocate questioned Mr. Reid about the treatment of certain categories of expenses. It appears that the Consumer Advocate attempted to include certain overhead expenses in the calculation of avoided costs. Due to the nature of the CSAs, the Commission has found that the BST proposed reference point of the point of sale is the appropriate reference point to determine if costs are avoided for CSAs. Witness Reid testified that overhead costs are not avoided costs because the cost calculations used to price CSAs do not include any amounts for overhead. Mr. Reid also offered that overhead costs are not avoided costs which is the standard required by the Act in setting a discount rate. Mr. Reid stated that inclusion of overhead costs should not be included as post-sale costs and are therefore not avoided costs for purposes of the CSA-specific discount. As the Commission has determined that the point of sale is the appropriate reference point to determine avoided costs for a CSA-specific discount, and as the evidence of record shows that overhead costs are incurred pre-sale rather than post-sale, the Commission finds that overhead costs, as proposed by the Consumer Advocate, should not be considered as avoided costs for purposes of the CSA-specific discount.

Witness Varner testified that Special Assemblies should receive the 14.8% resale discount that the Commission established in Docket No. 96-358-C. The record reveals

that while CSAs are developed in response to competitive situations and are discounted initially, Special Assemblies are not discounted. As Special Assemblies are not discounted initially upon creation, the Commission finds that Special Service Arrangements should receive the 14.8% discount previously approved in Docket No. 96-358-C.

Therefore, based upon the evidence of record, the Commission finds a wholesale discount rate of 8.98% is appropriate for CSAs and a wholesale discount rate of 14.8% is appropriate for Special Assemblies. While the record suggests that a different rate for CSAs resold to similarly situated third parties may be appropriate, the Commission finds nothing in the record to quantify a rate for those situations when CSAs are resold to similarly situated third parties. Therefore, the Commission finds that the 8.98% discount should also apply to CSAs resold to similarly situated third parties.

4. Reasonable and non-discriminatory limitations, or conditions, on the resale of CSA's by CLECs are appropriate and should be established.

Mr. Varner proposed the following limitations on the resale of CSAs by CLECS:

- 1) If a CLEC assumes all of the requirements (i.e. terms and conditions) on the contract (CSA), BST proposes that no termination charges apply at the time of assignment. A CLEC can take such action as adding or changing services that are provided for by the terms of the contract, and the CLEC is free to provide any other services subject to its agreement outside of the CSA. If the CLEC terminates the CSA early or does not comply with the terms and conditions of the CSA, the liability as stated in the contract should apply. If the CSA contains specific transfer charges, then those charges would apply when the CSA is transferred. If the CSA does not contain specific transfer charges, then tariffed transfer charges would apply.
- 2) A CLEC may resell a CSA to the customer for whom the CSA was constructed or to other customers that are similarly situated to the customer for which the CSA was developed. Customers shall be

deemed to be similarly situated when the quantity of use, time of use, manner of use, and costs of rendering service are the same.

Based upon the evidence of record from the hearing in this matter, the Commission finds that the limitations, or conditions, on the resale of CSAs by CLECs as proposed by witness Varner are appropriate. The Commission finds that these conditions are reasonable and non-discriminatory.

### **CONCLUSIONS OF LAW**

Based upon the above Findings of Fact, the Commission concludes as a matter of law the following:

1. 47 U.S.A. §252(d)(3) under the caption “Wholesale prices for telecommunications services” states: “For the purposes of section 251(c)(4), a state commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.”

2. Pursuant to the Petition of BST and 47 U.S.C. §252(d)(3), wholesale, or discount, rates for Special Service Arrangements, such as CSAs and Special Assemblies, should be established.

3. Pursuant to 47 U.S.C. §252(d)(3) wholesale, or discount, rates are to be established on costs avoided by the local exchange carrier as a result of the resale. In other words, a resale discount should reflect the costs the local exchange carrier will avoid as the result of the resale.

4. In determining a CSA-specific discount that reflects the costs avoided by BST as a result of the resale, the point of sale is the appropriate reference point for determining avoided costs and non-avoided costs.

4. Based upon the evidence of record and the Findings of Fact as determined above, the Commission concludes that the appropriate CSA-specific discount rate, utilizing the point of sale as the appropriate reference point for determining the discount rate, is 8.98%.

5. Based upon the evidence of record and the Findings of Fact as determined above, the Commission concludes that the appropriate discount rate for Special Assemblies is 14.8%.

6. Based upon the evidence of record and the Findings of Fact as determined above, the Commission concludes that the following limitations on the resale of CSAs by CLECs are reasonable and non-discriminatory and are therefore appropriate:

- (a) If a CLEC assumes all of the requirements (i.e. terms and conditions) on the contract (CSA), BST proposes that no termination charges apply at the time of assignment. A CLEC can take such action as adding or changing services that are provided for by the terms of the contract, and the CLEC is free to provide any other services subject to its agreement outside of the CSA. If the CLEC terminates the CSA early or does not comply with the terms and conditions of the CSA, the liability as stated in the contract should apply. If the CSA contains specific transfer charges, then those charges would apply when the CSA is transferred. If the CSA does not contain specific transfer charges, then tariffed transfer charges would apply.
- (b) A CLEC may resell a CSA to the customer for whom the CSA was constructed or to other customers that are similarly situated to the customer for which the CSA was developed. Customers shall be deemed to be similarly situated when the quantity of use, time of use, manner of use, and costs of rendering service are the same.

## CONCLUSION

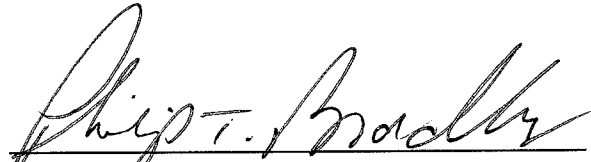
Based upon the Findings of Fact and Conclusions of Law as contained herein, IT  
IS HEREBY ORDERED THAT:

1. A CSA-specific discount rate of 8.98% is established and approved.
2. A discount rate for Special Assemblies of 14.8% is approved.
3. The following limitations of the resale of CSAs by CLECs are approved:
  - (a) If a CLEC assumes all of the requirements (i.e. terms and conditions) on the contract (CSA), BST proposes that no termination charges apply at the time of assignment. A CLEC can take such action as adding or changing services that are provided for by the terms of the contract, and the CLEC is free to provide any other services subject to its agreement outside of the CSA. If the CLEC terminates the CSA early or does not comply with the terms and conditions of the CSA, the liability as stated in the contract should apply. If the CSA contains specific transfer charges, then those charges would apply when the CSA is transferred. If the CSA does not contain specific transfer charges, then tariffed transfer charges would apply.
  - (b) A CLEC may resell a CSA to the customer for whom the CSA was constructed or to other customers that are similarly situated to the

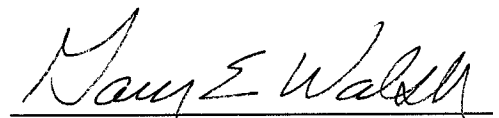
customer for which the CSA was developed. Customers shall be deemed to be similarly situated when the quantity of use, time of use, manner of use, and costs of rendering service are the same.

IT IS SO ORDERED.

BY ORDER OF THE COMMISSION:

  
Chairman

ATTEST:

  
Executive Director

(SEAL)